

ASSEMBLY REPUBLICAN LEADER
DAVE COX

THE 2002 BUDGET ACT FINAL BUDGET SUMMARY

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OVERVIEW

- ***Budget's \$23.6 Billion Problem Isn't Resolved.*** The AB 425 Budget Plan takes a short-term, triage approach to the 2002 State Budget. A host of deferrals, loans, fund raids and temporary tax increases are used to maintain existing state programs in 2002-03 and minimize the level of program reductions needed (see Chart 1 on page 3). However, at least some of the actions taken are unlikely to produce the anticipated savings or may be overturned in the courts. Further, the economy and thus state revenues are not performing as expected in the early months of this fiscal year, making it likely that Democrats will seek to impose new tax increases following the November election.
- ***Budget Proposes Slightly Reduced Spending Level.*** The Budget for 2002-03 proposes state General Fund spending of \$76.7 billion, which represents a slight decrease relative to General Fund spending in 2001-02 (\$140 million).
- ***Budget Contains \$2.4 Billion in Revenue Enhancements.*** The AB 425 Budget Plan contains \$2.4 billion in additional tax revenues for 2002-03. These additional revenues come from a number of separate proposals, the largest of which is a two-year suspension of businesses' ability to claim Net Operating Losses (\$1.2 billion) (see Taxes Section)
- ***Spending Cuts Up to \$8 Billion.*** Following two months of stand-off, Democrats finally agreed to an additional \$1.7 billion in spending reductions above the \$6.2 billion contained in the Senate budget plan. The Democrats rejected over \$5 billion of specific program reductions proposed by Republicans, opting instead for a \$750 million "across-the-board" reduction in state operations, a "golden handshake" expected to save \$285 million, and a reduction of the Proposition 98 "over-appropriation."
- ***More Cost Shifting to Future Generations.*** The budget now includes approximately \$8 billion in borrowed funds that will have to be repaid in future years – in some cases not until 2007-08. The largest of these is the Tobacco Securitization proposal, expected to generate some \$4.5 billion in funds for 2002-03 (see Tobacco Securitization). These loans essentially just delay the day of reckoning when the state's ongoing expenditures will have to be reconciled to its ongoing revenues.
- ***Fund Shifts and Sweeps Total \$2 Billion.*** The budget also relies on over \$2 billion in one-time resources obtained by shifting General Fund costs to other state funds or sweeping special fund balances into the General Fund. Using one-time resources to pay for ongoing programs means that additional resources will have to be found to pay for these programs next year, or that these programs will ultimately have to be eliminated. A wiser course of action would have been to eliminate them now, but instead the majority party wanted to have a Commission look at these issues before action is taken.
- ***Budget Proposal Leaves State with Large Structural Deficit.*** Because many of the budget's features are temporary, and many increase out-year expenses, the state still faces a huge structural deficit in future budgets. The LAO had estimated the size of the structural deficit at \$9.8 billion in 2003-04 based upon the Senate budget plan; although it is expected to be somewhat less than that amount under the final budget due to the additional reductions in spending.
- ***Federal Fund Proposals Still Unlikely to Materialize.*** The budget continues its reliance on \$1.1 billion in unlikely new federal funds, including new federal funding for Medi-Cal and relief from federal penalties related to child support program systems.
- ***Infrastructure Funding Mechanism Approved.*** As part of the final budget deal, ACA 11 (Richman and Canciamilla) was approved by both houses of the Legislature and will be submitted to the voters in 2004. This measure diverts a portion of General Fund revenues to a new infrastructure fund and used for state and local infrastructure projects.

Chart 1
How the \$23.6 Billion Problem Was Addressed
(\$ in Millions)

| | <u>Amount</u> | <u>Percent</u> |
|----------------------|----------------------|-----------------------|
| Program Reductions | \$7,458 | 31.5 |
| Borrowing | 8,611 | 32.2 |
| Fund Shifts/Sweeps | 2,332 | 9.4 |
| Education Deferral | 1,728 | 7.3 |
| Revenue enhancements | 2,451 | 10.4 |
| | | |
| Totals | \$23,642 | 100.0 |

TAXES

The 2002-03 Budget contains several revenue generating provisions relating to taxation that will result in approximately \$2.4 billion in additional revenue to the General Fund. The taxation provisions relating to the budget would suspend the Net Operating Loss deduction for two years and increase the deduction from 65% to 100% in 2004, change the tax treatment of bank bad debt reserves, expand real estate sales withholding to California residents, suspend the teacher tax credit, increase withholding for stock options and bonuses, suspend the land conservation tax credit, increase the surcharge on electricity, and reduce the interest rate the state pays for tax overpayments.

Taxes

2002-03 State Revenue Gain

| | |
|---|---------------|
| 1. Net Operating Loss - two year suspension | \$1.2 billion |
| 2. Banks - bad debt reserves | \$285 million |
| 3. Teacher Tax Credit - one year suspension | \$170 million |
| 4. Real Estate Withholding | \$225 million |
| 5. Stock Options Withholding | \$400 million |
| 6. Reduce interest rate on overpayments | \$24 million |
| 7. FTB & BOE penalties/waivers | \$145 million |

Total

\$2.4 billion

- ***Net Operating Loss Deduction (two years).*** The budget suspends the NOL for two years (2002 and 2003) with the ability to deduct these losses beginning in 2004. The budget would also allow an extension of the expiration date of an existing NOL for an additional two years. Finally, the budget would increase the percentage of NOL deduction in 2004 from 65% to 100%.
- ***Tax Treatment of Bad Debts for Banks (one-time).*** Changes the methodology for calculating deductions for bank bad-debt costs to limit these deductions to actual losses, rather than contributions to a reserve for bad debts. Requires large banks (assets over \$500 million) that have maintained reserves for the purpose of covering future bad debt (which are currently not state taxable) to pay tax on 50% of those reserves in 2002-03. The remaining 50% would not be taxed by the state.
- ***Waiving Penalties and Interest on "High Risk" Accounts (one-time).*** Authorizes the FTB, for the period beginning on October 1, 2002 and ending on June 30, 2003, to waive penalties, interest, and fees on "high risk" delinquent accounts if all payments equal to the tax owed are paid by June 30, 2004. "High risk collection account" is defined as any unpaid tax liability where satisfaction of that liability would be in the best interest of the state. In order for the FTB to collect "high risk" delinquent taxes, they would have to determine that efforts to collect the unpaid tax liability would not be economical or the unpaid tax liability would not be paid in full within a reasonable period of time. Finally, these provisions would only be in effect until December 31, 2004.
- ***Commercial Real Estate Withholding for California Residents (permanent).*** The budget extends the requirement of withholding of 3 1/3% of the sales price of commercial property, including apartments and rental homes, that currently applies to non-California residents, to residents. Exemptions to this requirement include property that is sold that does not exceed \$100,000 and property that is sold for a loss.
- ***Increase Withholding of Stock Options and Bonuses (permanent).*** The budget requires withholding of 9.3% of stock options and bonuses. Current law allows taxpayers a choice of

paying 6% or their marginal rate. This provision is retroactive and would be effective for stock options/bonus payments paid on or after 1/1/02.

- ***Teacher Tax Credit Suspension (one year).*** Suspends the teacher tax credit program for one year.
- ***Reduce interest rate on overpayments.*** The budget reduces the interest rate paid by the state on corporate and estate tax overpayments and unclaimed property held by the State Controller. This would reduce the interest rate to the lesser of the three-month treasury bill rate or 5 percent. This would have the effect of charging taxpayers who under-pay a higher interest rate than the state would have to pay for overpayments.
- ***Underpayment Penalty Waiver.*** Provides a wavier of potential penalties resulting from an underpayment of the tax provisions contained in this bill.

TOBACCO SECURITIZATION

The largest single feature of the final budget package is the Tobacco Settlement Securitization, under which the state's rights to receive revenue under the Master Settlement Agreement will be sold to investors for \$4.5 billion in up-front cash. The authorization for this measure is contained in SB 1831 (Peace), which will take effect on January 1, 2003. Under the Master Settlement Agreement, California is expected to receive up to \$500 million per year in perpetuity, with the actual amount depending upon such factors as cigarette sales volume and the market share of tobacco products companies subject to the settlement. Under laws enacted last year, these settlement revenues were to be deposited in the Tobacco Settlement Fund, and used to pay a portion of the state's costs for health programs.

Under SB 1831, all of the state's tobacco settlement revenues for up to the next 40 years will be pledged to retire the Tobacco Settlement Bond. However, the bond structure envisions that the bonds will be fully repaid after about 22 years, at a total cost of about \$11 billion in tobacco settlement revenues. This bond is expected to be issued by the Treasurer's Office next Spring, and produce about \$4.5 billion in net proceeds for deposit into the General Fund. The General Fund will expend these funds in 2002-03 to support the state budget, and will be required to "backfill" the lost tobacco settlement revenues in future years.

GENERAL GOVERNMENT

- **No Hiring Freeze for Tax Collectors.** The Budget Bill proposes to add 235 NEW positions for auditor and tax collection activities at the Franchise Tax Board. The total cost for the 235 NEW positions is \$20 million. This proposal is based on the theory that adding auditors and tax collectors will generate more revenue for the General Fund. The Budget Bill makes the assumption that the new positions as well as increased compliance efforts will result in an additional \$440 million to the General Fund. FTB's existing backlog of tax cases under protest is over \$1 billion dollars. Creating new positions while the FTB refuses to settle the cases in protest that total over \$1 billion makes little sense.
- **What Is Art? And Why Are We Still Spending \$20 Million?** The Budget Bill has left the Arts Council with a funding level of approximately \$20 million, effectively subsidizing artists while the state is facing one of the worst fiscal crisis in the history of our State.
- **More Borrowing, More Debt.** The debt-restructuring plan will reduce spending over two years (2001-02 and 2002-03) by a total of \$1.1 billion. The Treasurer's proposal achieves these savings primarily by delaying the payment of principal on existing debt. Under the proposal, existing bondholders would be paid off with the proceeds of refunding bonds, and the refunding bonds would be structured to pay interest only for the first four years. This means that, while the required bond payments would be less *initially*, they must be significantly higher *after* the four years to pay the extra interest that would accrue due to the higher level of principal outstanding. One of the effects of this proposal is to increase the amount of General Obligation Bonds that could be issued by the state in the near term, by moving to a "level debt service" payment methodology. Republicans question the need to provide additional state debt capacity at this time. Further, this extra debt capacity is clearly artificial, generated only by the gimmickry of "backloading" existing state debt so as to make room for more new state debt.
- **Gubernatorial Ambassadorships Saved.** The Budget Bill spends over \$4 million to retain seven foreign trade offices that are located throughout the world. There is no evidence that any of the offices increase trade activity with California. These offices have become sought-after Gubernatorial appointments from large political donors.
- **Implementation of the Workers Compensation Increase Adds to the Bureaucracy.** The Budget Bill contains over \$4 million to the Department of Industrial Relations for the implementation of AB 749, the \$2.4-\$3.5 billion workers' compensation benefit increase. The funding is for the new responsibilities for DIR contained in AB 749.

VETOED:

The Governor vetoed \$4.2 million for the implementation of AB 749, the measure enacted earlier this year to increase workers compensation benefits. The Governor has "...instructed the department to absorb the associated workload during the first six months of implementation..."

The Governor vetoed several items in the general government area that total just over \$10 million. These items include Democrat member "pork" within the Technology, Trade and Commerce Agency and funding from other Departments that reflect May Revision reductions which the Legislature chose not to reduce.

EDUCATION

- ***Democrats Defer Funding for Education Programs until 2003-04.*** The budget package defers \$681 million in funding for various education programs from 2002-03 to 2003-04, similar to the 2001-02 deferral. Among the programs that would be deferred is the Supplemental Grants program, which was initiated by Republicans to equalize funding for school districts that do not receive a fair share of categorical funding. This deferral has the effect of eliminating the Proposition 98 overappropriation in 2002-03.
- ***Budget Package Funds Equalization in 2003-04.*** In response to a Republican proposal to fully fund equalization for school districts in 2003-04, AB 2781 provides \$406 million for equalization, 50 percent of which is distributed based on a post-SB 727 formula and 50 percent based on a pre-SB 727 formula. This represents a significant gain, given that the 2001-02 budget provided only 10 percent of what was needed on a one-time basis. As of this writing, the Governor has not yet signed AB 2781.
- ***Funding is Cut for Core Instructional Programs.*** The budget provides \$400 million for the Instructional Materials Block Grant, which consolidated existing funding for instructional materials and classroom library materials. This reflects a reduction of \$20.9 million for instructional materials from 2001-02. This reduction is significant, given the State Board of Education's recent adoption of reading and language arts materials which is the most significant and costly standards-based adoption. Total funding for instructional and library materials is \$432.7 million, a reduction of \$171.7 million from 2001-02.
- ***Budget Usurps New Federal Special Education Funds.*** The Democrats are using \$119.4 million from an increase of \$131.6 million in federal special education funds to fund non-special education programs, instead of allowing these funds to supplement existing state and local funds for special education. After years of pressuring the federal government to take greater responsibility in covering the local costs of special education, the budget uses these funds to lower the state's contributions and leaves local school districts with a hollow victory. A mere \$8.2 million in new federal funds will be passed on to the schools for special education.
- ***Funding for Charter School Facilities is Reduced.*** The Democrats eliminated \$5 million for charter school facilities in 2001-02 in order to fund other priorities. This funding was intended for charter schools that serve low-income students.

VETOED: The Governor reduced education funding by \$143.3 million and set it aside for any contingencies in Proposition 98 in 2002-03. The reductions include, among other things, \$42 million for revenue limit equalization and \$36 million for the PERS offset. This funding would have provided much needed discretionary revenue to school districts.

Despite the Legislature's intent to include instructional materials in the Charter School Categorical Block Grant, the Governor is requiring that charter schools apply separately for the funding. As a result, charter schools will be subject to the program's restrictions. This contradicts the state's past policy of including instructional materials funding in the block grant.

HEALTH AND HUMAN SERVICES

HEALTH

- **Majority Rejects Many Cost Cutting Proposals.** The Administration proposed to save the state \$600 million General Fund by eliminating select Medi-Cal optional benefits, rescinding the expansion of the Medi-Cal 1931(b) program, reinstating Medi-Cal quarterly status reports, and reducing county Medi-Cal administrative funding. Republicans presented an additional \$330 million (General Fund) of cost cutting proposals during the Budget Conference Committee. However, the Majority rejected all of these proposals and opted instead to implement the new program expansions discussed below.
- **Medi-Cal Expansion - Express Lane Eligibility.** This new Medi-Cal expansion, which utilizes the National School Lunch Program as a basis for preliminary Medi-Cal eligibility could cost over \$100 million in future years due to increased and accelerated enrollment in Medi-Cal of children who have been determined eligible for free school lunch. Most Republicans opposed this program because it automatically enrolls children in Medi-Cal if their parents *express an interest* on their school lunch program application, and it would enroll children in limited scope Medi-Cal even if the parents decide not to participate. The state should not automatically enroll anyone in a government-sponsored program. This is especially true when so many at that income level don't want to be on what is traditionally known as a “welfare program.”

VETOED: \$5.9 million for the Medi-Cal expansion that would link children's Medi-Cal eligibility with eligibility under the National School Lunch Program.

- **State Sanctioned Fraud (A.K.A Accelerated Enrollment).** This new program expansion provides **free Medi-Cal health coverage** for anyone that applies until they are determined to be ineligible. The cost of *accelerated enrollment* is the cost of providing services to persons who are not otherwise eligible or will not complete the application process. The budget assumes that 23% of Medi-Cal application forwarded to counties through the Single Point of Entry will meet these conditions, which is estimated to cost \$5.4 million. It is possible the costs could in fact be much higher, particularly when coupled with the *Express Lane Eligibility* Medi-Cal program expansion.
- **Healthy Families Parental Expansion.** The budget includes \$153 million (\$52 million General Fund) to expand the Healthy Families Program to the parents of eligible children. This includes an estimated 4,596 parents who will be enrolled in the State-Only portion of this program (i.e., no federal financial participation) because of their immigrant status. It is important to note that the cost represents partial year (October 1, 2002) implementation and the **future years General Fund cost will be well over \$100 million.**

VETOED: \$52.4 million to eliminate funding for the Healthy Families Program Parent expansion.

- **Healthy Families Bridge.** As part of the Healthy Families Parental Expansion, the budget includes an additional \$22 million (\$7.6 million General Fund) for a “bridge” for these parents. The *Healthy Families Bridge* provides **free coverage for two months** to parents that are no longer eligible for the program in order to give them time to checkout their options for other health coverage. More free coverage for ineligible people, which the state simply cannot afford.

VETOED: \$7.66 million to eliminate the legislative augmentation for the Medi-Cal to Healthy Families two-month bridge.

- ***Child Health and Disability Prevention (CHDP) Gateway.*** In January, the Governor proposed eliminating this program because the age and income limits for eligibility are virtually the same as for Healthy Families and Medi-Cal. However, under pressure from various advocate groups the Administration rescinded the proposal, which would have resulted in savings of about \$50 million. Instead the budget includes an increase of \$48.2 million General Fund to retain the CHDP Program and another \$3.9 million General Fund to provide a new “gateway” from CHDP to Medi-Cal or Healthy Families. The CHDP “Gateway” will result in additional increased state costs ***in excess of \$50 million*** due the new *preenrollment* program, which ***provides free Medi-Cal coverage*** to any child (eligible or not) enrolling in CHDP for as long as it takes to make an actual eligibility determination. This represents yet another opportunity for the state to pay for health coverage for people who are not even eligible.
- ***CHDP Benefit Expansion.*** In addition to the CHDP Gateway program expansion, the budget includes \$2 million General Fund to increase the level of service under CHDP to be consistent with that of the American Academy of Pediatricians. The \$2 million augmentation underfunds this benefit expansion since the full year cost is at least \$7 million.

VETOED: \$2.0 million for updating the Children’s Health and Disability Prevention Program periodicity schedule.

- ***Medi-Cal Provider Rates Reduced.*** While Medi-Cal program expansions continue to be funded, the budget proposes to *cut* provider rates by over \$253 million (\$126.5 million General Fund). The exceptions are California Children’s Services, Home Health, Non-Emergency Medical Transportation, and Family Planning Physician Office Visits. Republicans have argued for many years that underpaying providers is tantamount to a tax and forces them to shift costs onto their other patients. In addition, imposing lower than market rates on Medi-Cal providers reduces their ability to offer free or reduced cost care to the indigent and uninsured and thereby weakens the safety net on which they rely. Increasing rates also serves to increase access by encouraging providers to accept Medi-Cal clients. *Apparently, some believe the best way to maintain the safety net and increase access to health care is to reduce rates and encourage providers not to serve Medi-Cal clients.*
- ***Reinstating the Disproportionate Share Hospital (DSH) Administrative Fee Rake-Off*** The Medi-Cal DSH program was established to provide supplemental funding to hospitals that treat a large number of low-income patients. The budget increases the administrative fee by \$55 million, which brings the total DSH rake-off to over \$85 million. By increasing the DSH administrative fee the budget effectively reduces the amount available for eligible hospitals, taking money away from hospitals that are struggling to serve the most vulnerable populations.
- ***State Forces Rebates and Discounts from Drug Manufacturers, Medical Suppliers, and Pharmacies.*** The budget assumes over \$200 million in General Fund savings through a variety of forced rebates, contracts, utilization controls, and reimbursement rate reductions. Among other things, the budget would require manufacturers to pay a state rebate on AIDS and cancer drugs, and cap reimbursement for all drugs. It would also require medical suppliers to contact for enteral (nutritional) formulae, and limit payments for enteral formulae and diabetic testing supplies. Additionally, the budget rescinds current and future pharmacy dispensing fee increases of \$0.25 and \$0.15 per prescription, and modifies the reimbursement rate for incontinence supplies. It is not clear that the Department of Health Services will be able to achieve the level of anticipated savings due to implementation timeframes. In any case, this may simply result in cost shifting somewhere else.
- ***Doubtful Fraud Savings.*** The budget assumes \$655 million (\$327 million General Fund) of savings generated from recent expansion of Medi-Cal anti-fraud efforts. This represents a \$490 million increase in fraud savings above the 2001-02 fraud savings level. This dramatic increase in fraud savings does not seem plausible. Republicans are concerned that the taxpayers will be

on the hook for the Department's funding deficit next year when these "fraud savings" do not materialize.

VETOED:

- 1. \$29.0 million of the \$87 million legislative augmentation, which partially restored the administrations, proposed 20% reduction to Medi-Cal county administration.*
- 2. \$5.0 million of the \$25 million legislative augmentation for support of the state's trauma system providers.*

HUMAN SERVICES

- ***Federal Funds Delayed.*** The Governor's May revise reflects net General Fund decreases of \$39.6 million in the current year and \$91.5 million in the budget year, reflecting the receipt of additional Federal Funds for additional clients served under the Medicaid Waiver. We have to ask what took so long? As of 6/30/00, the number of clients on the waiver was approximately 28,000 with 45,000 client slots available, on June 30, 2001 the number of clients participating in the waiver increased slightly to 30,000 while the cap remained at 45,000. Had the administration moved more quickly to secure the funding available under the waiver we could have realized the same magnitude of savings in FY 99/00, 00/01 and had elevated savings in the current and budget years.
- ***Budget Includes Some Creative Funds Laundering.*** The Governor's May revise reflects a net General Fund Savings of \$23.5 million in the Current Year and \$35.0 million in the Budget Year. These General Fund savings result from a complicated accounting scheme by which different types of federal funds are manipulated resulting in a substitution of federal Temporary Assistance for Needy Families funds to pay for activities that have historically been funded by the General Fund.
- ***Feds Fine Administration for Failure to Control Error Rates within the Food Stamp Program.*** The May revise includes a General Fund increase of \$11.6 million to pay the State's 10% share of the \$115.8 million federal penalty assessed against California because of excessive error rates experienced in the administration of the Food Stamp program. The national average error rate is 8.7 percent and California's is 17.4 percent.
- ***Unfulfilled Federal Dreams.*** Among other assumptions, the Governor's January 10 budget assumed that California would be able to offset General Fund expenditures by \$216 million in more new federal funds. Of this amount, \$180 million was to be realized by the Federal Governments forgivance of the penalty it had assessed because of the state's failure to implement a single statewide-automated child support collection system. The remaining \$35 million in savings was to come from federal action to restore food stamp benefits to legal immigrants that arrived after 1996. However, neither of these assumptions has come to fruition. Based on revised assumptions, the May revise proposes to restore \$183.4 million or 85% of the funds proposed for reduction in January (\$93.7 million for Food Stamps and \$89.7 million for a possible alternate penalty). It isn't likely that these new assumptions fare any better than the old ones.
- ***Budget Raids Reed Act Funding for General Fund.*** On March 9, 2002, President Bush signed an economic stimulus bill that included a one-time \$8.0 billion distribution to states. California's share was \$936.9 million. These funds were authorized to stabilize states' Unemployment Trust Funds (maintaining solvency in the face of the additional costs resulting from the economic downturn) ensuring that benefits are available to laid off workers, and that employer contributions would remain at existing levels. The overall logic was to avoid the necessity of increasing employer taxes to provide the envisioned increased benefits. The Administration's May revise proposes to use \$40.1 million (\$5.7 million CY and \$34.4 million BY) in Federal Reed Act funds to offset ongoing General Fund obligations. In addition, the Legislature utilized \$141 million of Reed Act funds to fund a wide variety of programs.

VETOED: The Governor vetoed the following augmentations:

1. *Approximately \$140 million from a variety of programs, which were, augmented over Republican member objections that the augmentations defeated the federal Governments intent to stabilize the UI trust fund. This action restores the funds to the UI trust account.*
2. *\$1.5 million from veteran employment services.*

- ***Unjustified Creation of New Agency.*** The Conference Committee took action to create a new Labor and Workforce Development Agency effective July 1, 2002. Republicans argued that the only information supporting this endeavor is anecdotal and that in the midst of the largest deficit the state has ever faced our resources would be better expended resolving our current fiscal condition. Consistent with this position, the Little Hoover Commission, upon reviewing the plan submitted by the Davis administration noted that “it does not contain any details on how the programs would be managed differently”. The only result that we can be assured of is that the new agency would provide a number of highlevel positions that would eventually be filled by Davis administration cronies.
- ***Savings Booked Without Adequate Tool to Secure.*** The conference committee imposed a \$52 million unallocated GF reduction on the Department of Developmental Services, Regional Centers Purchase of services budget. However, the services that this reduction will curtail are services to which Developmentally Disabled individuals are entitled under the Lanterman Act. That is why, when the administration proposed this reduction, it included language to standardize the purchase of services throughout the state. Therefore, as adopted by the committee, the \$52 million in will likely never be realized because the appropriate tool to achieve the savings has not been provided.
- ***Ill timed augmentation.*** The budget includes an augmentation of \$5.6 million for one-time grants to develop community resources. This will likely result in a back door rate increase for service providers.

VETOED: The Governor vetoed the following augmentation:

1. *\$5.6 million for one-time Community Placement Plan Grants to develop enhanced community resources.*

- ***Fiscally Irresponsible Language.*** The budget assumes savings of \$30 million in the Department of Mental Health’s Early and Periodic Screening Diagnosis and Treatment Program. These savings are proposed to come from adoption of managed care principles that any will run organization should already be employing. To insure that the booked savings are attainable, statute should have been modified so that counties share in the cost of the program at a level of at least 10 percent. This would cause the counties to be more responsible in controlling the rapidly increasing costs this program is experiencing.
- ***Hijacked Authority.*** The conference committee adopted trailerbill language that will require the state to pay 100% of the costs of mental health services delivered to children in the public school system. This action inappropriately usurps the authority of the Mandates Claim Commission, the body established by the Legislature to determine the appropriate share of costs governmental entities should bare relative to state policies. This action will result in added state costs of at least \$10 million (all GF).
- ***General Fund “Backfill” due to Loss of Federal Funds.*** The budget includes an increase of \$15.3 million General Fund to backfill for a loss of federal certification at the Porterville and Canyon Springs developmental centers.
- ***Higher Health Benefit Costs for State Janitors.*** The budget includes an increase of \$8.8 million (\$5 million General Fund) to cover the higher costs of janitorial health benefits.
- ***Budget Increase for Autism.*** The budget includes an increase of \$17.2 million for this program.
- ***Majority of Governor’s Proposed Cuts to Adult and Children’s Systems of Care Rejected.*** The Governor proposed eliminating these programs for total savings of \$42.6 million. However, the budget restores \$30 million General Fund for the Children’s System of Care and \$2 million General Fund for the Adult Systems of Care, with \$1 million going to each Los Angeles and Stanislaus Counties.

VETOED: The Governor vetoed the following augmentations:

- 1. \$13.8 million from the \$33.8 million legislative augmentation made to restore approximately 3/4ths of the reduction originally proposed by the Governor for the Children's System of Care.*
- 2. \$10 million from Integrated Services for Homeless Adults leaving a balance of \$55.6 million for this program.*
- 3. \$2.0 million from the Adult System of Care.*
- 4. \$5.4 million in reimbursements which were added by the Legislature when it rejected the administrations proposal to implement a county share of cost for the Early and Periodic Screening, Diagnosis and Treatment program.*

- ***Establishment of an Experimental Drug Court Partnership Program.*** The conference committee adopted a proposal to establish a felony only drug court partnership program. Under this program District Attorneys and the courts would be able to treat rather incarcerate non-violent drug felons. Funding for the program, in the amount of \$6.1 million (GF), has been provided from savings, anticipated to be realized via this program, in the department of Corrections due to the anticipated reduction in correctional facility populations this program may provide.
- ***Restoration of Discretionary CALWORKS Cost of Living COLA.*** The Governor proposed suspending the October 2002 cost of living COLA for GF savings of \$12.5 million. However, the Conference Committee took action to restore this COLA effective June of 2002. This action ensures that the October 2003 COLA will be calculated and awarded as though the suspension never occurred. The General Fund impact of this modification will be an additional \$12.5 million in fiscal year 2002/03 and \$150.2 million in fiscal year 2003/04.

VETOED: The Governor vetoed the following augmentations:

- 1. \$16.5 million thereby reducing funding for county administration of food stamps.*
- 2. \$17.1 million for cost of doing business in the Child Welfare Services Program.*
- 3. \$3.0 million for cost of doing business in the Adoptions program.*

TRANSPORTATION

- **More Highway Robbery.** In the 2001/02 budget, the Governor deferred the transfer of the sales tax on gasoline revenues for two years in order to address the state's fiscal problems. In January, 2002, with the numbers again looking grim, the Governor proposed to "loan" \$672 million from the Transportation Congestion Relief Fund to provide support for the General Fund. The Conference Committee approved loans of an additional \$373 million from the TCRF and \$173 million from the State Highway Account. Repayment for the \$173 million will be required in the 2004/05 fiscal year. The Governor continues to assure us that no project shall be delayed as a result of these loans and deferrals.

VETOED: The Governor deleted the provision in the budget act that required the transfer of State Highway Account funds to the TCRF to be made only on an "as needed" basis because the language is unnecessarily restrictive and interferes with the Administration's ability to manage State programs. In other words, the Governor wants no restrictions placed on his ability to "borrow" from other funds.

- **Ghost positions continue to be funded.** The Governor proposed a reduction of \$38.1 million and the elimination of 550 positions. (The department will achieve the entire reduction from attrition, not from abolishment of any of their 1,228 vacant positions.) Should there be any local projects that require it, the Administration proposed to fill those positions on an as-needed basis. The Conference Committee refused to approve the Governor's proposal and instead, approved a "compromise", with Republicans dissenting, to divide the workload reduction evenly between contract employees and state workers. This, in spite of the fact that the Department of Finance maintained that they have no work for the 550 positions and that if they do not abolish those positions as they become vacant during the budget year, there will be massive layoffs in budget year plus-one.

VETOED: The Governor vetoed or reduced funding for the following items:

1. *\$5.1 million legislative augmentation for Special Transportation Programs.*
2. *\$1.5 million reduction in the unexpended funds for the childcare center at the transit station project in Santa Clara County.*
3. *Reduced the State Local Partnership SHA allocation by \$16.937 million leaving a balance of \$72 million available for programs.*
4. *Reduced the Program 20.30 Highway Transportation – Local Assistance allocation by \$48.72 million leaving a balance of \$17 million available for programming.*

RESOURCES AND ENVIRONMENT

- **Bond Funds and Fees Do All the Heavy Lifting for Environmental Programs.** In order to fund budget reductions, a lot of environmental program funding was shifted from General Fund support to Proposition 40. The Conference Committee voted to adopt the Governor's proposed a spending plan of \$792.35 million for selected projects and programs. There will be no per capita grants in the budget year because there is still funding left for those programs in Propositions 12 and 13. Acquisition and development of the State Park System will receive \$204.7 million to fund specific park projects. The state's conservancies will receive \$215.5 million. The Clean Beaches, Watershed Protection and Water Quality Projects are allocated \$164 million and Cultural and historic projects will receive \$107 million. Some of these funds are being used by departments to shift away from General Fund spending for ongoing programs such as CALFED.

VETOED: The Governor vetoed Control Section 9.40 – Proposition 40 Administration Cost Limits. That section restricted the administrative expenditures from Proposition 40 allocations to a maximum of 5 percent of budget appropriations for all grant programs and property acquisitions made in the budget year. The Governor interprets Proposition 40 to require that all program delivery and administrative costs be paid through the Bond Act. The Governor goes on to state that the expenditure plan set forth by the Administration in June meets current priorities and is fiscally responsible. The Governor's plan includes administrative and operating expenses for Administration Agencies and Departments off the top of the allocated funding. While most of these allocations fall within the 5 percent range, there is no prohibition to exceeding the 5 percent as there would have been had Control Section 9.40 been retained.

- ***Fee Proposals Bite the Dust.*** Perhaps the best news out of this year's budget for the environmentally regulated community was the demise of almost all the fee proposals recommended by the budget subcommittees as a way to free up General Fund money for other projects. The proposals to support Timber Harvest Plan review costs by the addition of another four cents to the timber yield tax was defeated as were the proposals for a stationary source emissions fee, and the power plant siting fee. Another big fee proposal by the Governor was to assign \$20 million for fire suppression costs to local agencies. Unanimously, the Conference Committee agreed that this is likely to be one of the worst fire seasons in years and now is not the time to play budget games with people's life and property.
- ***Fire Suppression Costs Restored.*** The budget restores \$75 million for fire suppression expenses. After months of accounting legerdemain and pretense, the Administration agreed that, in what promises to be one of the worst fire seasons on record, they could no longer ignore the fact that fire suppression costs could well exceed the \$85 million annual average cost and had to be an acknowledged expense in the Budget Act.
- ***Not All Fees Escaped Increases.*** The budget provides for an increase in the existing waste discharge fee from the current \$10,000 to \$20,000. While Republicans opposed raising this fee, we did support the decision not to add agricultural interests and minor dischargers to the fee base. Instead of creating a power plant siting fee, the budget provides for an increase of 1 mill in the ERPA electricity surcharge cap for potential revenue of \$22 million annually. This revenue will be used to fund the Energy Commissions powerplant siting program. The Governor proposed to offset previous General Fund costs for some environmental programs with bond funds and new fees.
- ***Fishing in the City Survives.*** After repeated attempts to zero-out this program, the final budget provides \$927,000 in Fish and Game Preservation Funds as the state match for \$77,000 in federal funds. This program stocks urban ponds with fish in Los Angeles, San Francisco, and Sacramento.
- ***CalFed Remains Healthy.*** In spite of Republican attempts to remove all General Fund contributions to this program, the budget includes \$476.7 million in General Funds, bond funds, and other special funds to support CalFed for yet another year. The federal government is over \$1 billion in arrears on its share of funding for the Record of Decision and all indications are that there will be no funding in the federal budget for the third consecutive year. CalFed supporters within the Administration believe that with the passage of a governance statute the federal Administration will be convinced of the validity of the project and that federal funds will be forthcoming. The Bush Administration and both houses of Congress have expressed a high degree of skepticism about the effectiveness of the program and its multibillion-dollar costs over thirty years.

VETOED: The Governor vetoed or reduced the following items in the Resources and Environmental Protection budget proposals:

- 1. Reduced - \$230,000 from the Special Resources Program within the Resources Agency. This funding is used to provide the state match for federal grants under the National Sea Grant College Program Act. Even with reductions, \$200,000 remains to support the program.*
- 2. Reduced - \$2 million for the Legislative augmentation for the Waste to Energy Program within the Energy Commission is reduced. This augmentation was to be used to address water pollution problems associated with dairies.*
- 3. Reduced - \$8 million from the Santa Monica Mountains Conservancy capital outlay acquisitions and \$5 million from the Baldwin Hills Conservancy million for capital outlay acquisitions.*
- 4. Vetoed – \$1.3 million for a legislative augmentation to the Air Resources Board for Community Health grants and \$500,000 for a legislative augmentation for Global Warming.*
- 5. Reduced - \$5 million reduction in the legislative augmentation to the Air Resources Board for subventions to local air districts.*
- 6. Deleted - \$709,000 in the legislative augmentation to the Office of Environmental Health Hazard Assessment for risk assessments, evaluations of contaminants and the development of standards.*

CRIMINAL JUSTICE

- ***Governor solves Budget Crisis by Releasing Prisoners.*** The Budget includes the Governor's proposal to double "good-time" credits for inmates working in CDC firecamps. Inmates assigned to the conservation camps will now receive two days credit for every day of time served. The early release of prisoners will generate approximately \$16.6 million annually for the state. However, because prisoners will cycle through the camps so fast, this increase in credits raises questions about the integrity of the camps and the level of prisoners that will be allowed to participate in the program.
- ***Court Costs Skyrocket, Unfairly Burdening Average Citizens.*** The Budget includes an increase of 10% for court fees and 20% for criminal fines. According to the Administration, these assessments will generate approximately \$60 million annually in additional revenues. This increase along with SB 1732 (Escutia), which provides financial support for the court facilities takeover, brings the total state penalty assessment on criminal fines up to nearly 200%. A majority of the revenues for criminal fines come from traffic violations making this increase nothing more than a fee increase on drivers. It is also important to note that as the fee increases collection generally decreases because of inability to pay or judicial discretion in lowering fines which may have an impact on other programs such as victims restitution and peace officer training which use this same funding source.
- ***Budget Slashes High Tech Grants.*** Last year law enforcement received \$34.5 million in grants for high technology purchases. This year the Budget provides \$18.5 million, consistent with the Governor's proposed reduction. In addition to the overall cut, the minimum grant for cities and counties was also reduced from \$30,000 to \$15,000, which would favor larger cities and counties over small rural areas.
- ***Programs for the Mentally Ill and Gang Members Reduced.*** Numerous programs affecting the mentally ill, juveniles, and gang members were the subject of large cuts. Among those programs reduced were the Challenge Grants, Mentally Ill Offender Crime Reduction, Rape Crisis, Homeless Youth Project, Serious Habitual Offender, and the Cal Gang Violence Suppression Program.
- ***Despite Budget Standoff, Law Enforcement Escapes Deep Cuts.*** Throughout the year the Governor proposed several large cuts to local law enforcement. However, most of these cuts were restored or rejected by the Legislature. The Budget provides full funding for several programs including:
 - ***War on Methamphetamines*** - The Budget would retain \$15 million in funding for the Central Valley High Intensity Drug Trafficking Area. The Governor proposed funding at \$10 million.
 - ***Vertical Prosecution Programs*** - The Budget includes \$18.2 million for five existing prosecution programs. The Governor proposed to reduce these programs to \$9 million.
 - ***Rural Crime Prevention*** - Budget includes \$3.5 million for the rural Crime Prevention Program. In May the Governor proposed to reduce this program to \$1.7 million.
 - ***High Tech Task Force*** - The High Technology Theft Apprehension and Prosecution Program was restored to \$14.2 million. This program provides assistance to local agencies targeting crime in the technology sector. The Governor's plan would have reduced this program by \$4.2 million.
 - ***COPS & Juvenile Justice.*** The Budget includes \$232 million for these programs despite the Governor's proposal to totally eliminate juvenile justice grants. However, Control Section 3.25 would allow the Director of Finance to delay distribution of half of these funds until January 30, 2003 making them a target for future cuts should state revenues continue to decline.

LOCAL GOVERNMENT

- ***Budget Expands ERAF to Redevelopment Agencies.*** The Budget would require redevelopment agencies to contribute \$75 million for one-year. Funds would be collected 50/50% from gross and net revenues of the individual agencies.
- ***Budget Leaves Locals without Mandate Funding.*** Payments to local agencies for mandated programs were all reduced to \$1,000 each. This reflects the Governor's May Revision proposal to continue mandate requirements but suspend payments to local governments until some future year. While the plan suggests that payments will be made at some later time, it is unlikely given that the state will owe approximately \$1.5 billion in back payments by the end of the year. Essentially this means local governments will be hung out to dry until they sue the state for money that is constitutionally owed to them.

Appendix I

2002-03 Budget Trailer Bills

| Bill | Author | Title |
|---------|----------------------------|---|
| AB 425 | Oropeza | 2002-03 Budget Act |
| AB 442 | Budget | Health Budget Trailer Bill |
| AB 444 | Budget | Omnibus Social Services Trailer Bill |
| AB 593 | Oropeza | State Government Spending Reductions |
| AB 1768 | Oropeza | General Government Budget Act Implementation |
| AB 2065 | Oropeza | Taxation |
| AB 2781 | Oropeza | Education Finance |
| AB 2785 | Oropeza | Education Finance |
| AB 2996 | Budget | Transportation |
| AB 2997 | Budget | Parks And Recreation And Coastal Protection: Grants |
| AB 2998 | Budget | Instructional Materials |
| AB 3000 | Budget | General Government Budget Act Implementation |
| AB 3002 | Budget | Budget Trailer Bill: Redevelopment Agencies |
| AB 3004 | Budget | Budget Trailer Bill: City Of Millbrae Loan Forgiveness |
| AB 3009 | Budget | Conservation |
| AB 3010 | Budget | Unemployment Insurance |
| ACA 11 | Richman and Canciamilla | Infrastructure: Finance. |
| HR 96 | Wesson | Speaker's Commission |
| SB 1831 | Peace | Tobacco Assets: Sales |
| SB 1834 | Budget | Transportation: Funding. |